TE TAI ŌHANGA
THE TREASURY

AC-4-5-24

17 May 2020

Mr Ross Smith
Program and Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario MSV 3H2
CANADA

Dear Ross

EXPOSURE DRAFTS – IPSASB EE-75 LEASES

Thank you for the opportunity to respond to the IPSASB Exposure Draft (ED) 75 Leases. The New Zealand Treasury is responsible for the New Zealand Government's accounting policies that comply with NZ GAAP for the public sector based on IPSAS.

The attachment to this letter set out NZ Treasury's response to the specific matters for comment. Broadly NZ Treasury agrees with ED 75 Leases but has a number of suggestions for improvement that would make the standard more useful to the public sector. A separate letter provides our response to the Request for Information on Concessionary Leases and Other Arrangements similar to Leases.

We trust you will find this response useful in your further deliberations. If you have any queries regarding Treasury's comments, please contact Ken Warren or Angela Ryan by email to ken.warren@treasury.govt.nz or angela.ryan@treasury.govt.nz

Yours sincerely

Jayne Winfield

Jayne Winfield
Manager, Fiscal Reporting

1 The Terrace
PO Box 3724
Wellington 6140
New Zealand

tel. 64-4-472-2733

https://treasury.govt.nz

ATTACHMENT

Exposure Drafts 75: Specific Matters for Comment

> **Specific Matter for Comment 1:**
>
> The IPSASB decided to propose an IFRS 16-aligned Standard in ED 75 Do you agree with how the IPSASB has modified IFRS 16 for the public sector? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

The New Zealand Treasury considers there are significant benefits to be obtained from international harmonisation of accounting standards and from harmonisation, where possible, between private sector and public sector standards. The arguments are well trodden: the economic substance of most transactions are not impacted by ownership/control structures of the entity, a common accounting language creates more understandable and more comparable information and unnecessary, costly and distracting differences are avoided, not least when preparing multi-sector consolidated financial statements.

Nevertheless, the proposal of an IFRS 16-aligned Standard for leases give us pause. We have observed significant costs being incurred by private sector in implementing IFRS 16. We are also aware that there will be a significant impact on fiscal targets and on public sector financial management that centralises financing decisions and decentralises operating decisions. Adoption of the standard with the removal of the operating/financing distinction for lessees will require revisiting these matters., Put simply the costs of adopting an IFRS 16-aligned standard are much higher than usual. What is usually an easy decision is now more of a line call.

On balance we support the introduction of an IFRS 16-aligned Standard for leases. There is now global acceptance of a model for leases that recognises assets and liabilities for the rights and obligations they create. The economics of a lease transaction are the same in both the public and private sectors. We acknowledge that adopting an IFRS 16 approach will result in a more faithful representation of a lessee's assets and liabilities.

However, this does not distract from the enormity of the change. We urge the IPSASB to give due consideration to that when determining the transition date to the new standard. We note that the IASB approved IFRS 16 in January 2016, with an implementation date for annual reporting periods beginning on or after 1 January 2019, despite some arguments that the same implementation date of 1 January 2018 would better harmonise with the transition date of the revenue standard. Implementation will be no easier for public sectors and may be more difficult when issues such as fiscal targets and GFS alignment are taken into account.

Turning to the question as to whether the Treasury agrees with how the IPSASB has modified IFRS 16 for the public sector, the first point that the Treasury notes is that the IPSASB has decided not to provide an explicit scope exclusion for concessionary leases. We understand that the IPSASB has explicitly agreed to consider issues related to concessionary leases in phase two of the project and therefore does not wish to pre-empt that work.

However, in the meantime, preparers must apply standards as best they can. In relation to concessionary leases, two arguments are possible:

- A concessionary lease is a lease and is therefore covered by ED 75. This requires a lessee shall initially measure the right-of-use asset at cost. If the cost of a right-of-use asset is nil or a nominal amount, then a nil or nominal value should be reported for the right-of-use asset and the lease liability,
- A concessionary lease is not an exchange transaction and is therefore covered by IPSAS 23. This requires that an asset acquired through a non-exchange transaction shall initially be measured at its fair value and the inflow of resources recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.

If the IPSASB intends either one or both of these options to be followed then, in the public interest, it should explicitly state that. Otherwise unwarranted costs are likely to fall on preparers and auditors and different judgements made. In the Treasury's view, so as not to pre-empt the IPSASB's analysis in phase two of the project, both options should be acknowledged as acceptable until the final conclusions are promulgated. That could be achieved by addressing the issue in the Basis of Conclusions.

The second modification that the IPSASB considered was whether the standard should be extended to binding arrangements. The Treasury had difficulty following the IPSASB's logic in not using that term. Generally IPSASB literature uses the term "binding arrangements" (defined as contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract) to avoid the problem that arrangements of similar economic substance to contracts are treated consistently. The Treasury does not understand why that approach is not followed in ED 75. Limiting the standard to "contracts" may mean that binding arrangements that should be treated as leases are not.

The rationale for excluding manufacturer or dealer lessor requirements is not persuasive. While they may not be expected to be applied, and may not have been specifically requested, the public sector is not prohibited from manufacturing or dealing activities. Non-inclusion of requirements in an aligned standard should be limited to requirements that are not considered to be appropriate, and not be extended to requirements that simply may not be generally applicable.

Specific Matter for Comment 2:

The IPSASB decided to propose the retention of the fair value definition from IFRS 16 and IPSAS 13, Leases, which differs from the definition proposed in ED 77, Measurement. Do you agree with the IPSASB's decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

The Treasury agrees with the IPSASB's decision to retain the fair value from IFRS 16.

The Treasury notes that the fair value definition proposed is consistent also with IPSAS 9. It is helpful for understanding if the term "fair value" means the same thing in different standards.

Specific Matter for Comment 3:

The IPSASB decided to propose to refer to both "economic benefits" and "service potential", where appropriate, in the application guidance section of ED 75 on identifying a lease. Do you agree with the IPSASB's decision? If not, please explain your reasons. If you agree please provide any additional reasons not already discussed in the Basis for Conclusions

The Treasury agrees with the proposal to refer both to "economic benefits" and "service potential", where appropriate, in the application guidance section of ED 75 on identifying a lease.

Doing so is not only consistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* but also ensures that leases of assets that provide public goods is covered by the standard.